Three takeaways as the Bank of England hikes rates

The Bank of England has hiked rates and the hawkish tone of the statement has taken markets slightly aback. But despite the Bank's optimistic outlook, we think policymakers will find it tricky to hike rates again before Brexit. We don't expect another rate rise before May 2019

Source: Bank of England

The Bank of England has opted to increase interest rates for only the second time since the financial crisis, but for investors what really matters is what it has – or hasn't – said about its next steps. Here are our three key takeaways

1 The Bank's unanimous decision came as a slight surprise for markets

Back when the Bank of England hiked in November, two voters (John Cunliffe and Dave Ramsden) dissented, preferring to keep rates on hold. This time, however, the committee was much more united. Ramsden – who said recently that he is “more comfortable” with the balance of risks – voted in favour of a hike. And despite recently making the case for “stodginess” in the approach to setting policy, Cunliffe decided not to dissent either. That meant that today’s decision to raise rates was unanimous, which may have caught some investors slightly off-guard.

2 The Bank remains upbeat on growth - we are more cautious

Back in May, markets weren’t totally convinced by the Bank’s bold assertion that the first quarter economic weakness was temporary. But generally speaking, the data since then has backed up the BoE’s story and it’s clear they remain comfortable with the outlook. Whilst it did give a nod to trade tensions and Brexit uncertainty in the minutes, it continues to expect business investment and trade to support activity and it now expects a slightly higher path of growth in the medium term.

We are more cautious. Once the effect of the sunny weather starts to fade, the cracks in the high street are likely to resurface. Consumers remain cautious, and real incomes remain under pressure (even if they are no longer falling). And given that Brexit uncertainty is only likely to ramp up, we think investment is likely to stay subdued too.

3 Few hints about the Bank's next steps as 'no deal' chatter increases

Going into Thursday’s meeting, markets were anticipating the next rate hike in roughly a year’s time. But given the Bank’s outlook for growth and inflation, we think policymakers would ideally prefer to raise rates before then. The big question going into this meeting was whether they’d come out and say so explicitly.

In the end – unsurprisingly - they didn’t. Aside from reiterating that “ongoing tightening” was needed, the Bank offered no stronger signals of intent. We suspect this is because policymakers are acutely aware that Brexit could make it increasingly complicated to increase rates again before the UK leaves the EU in 2019. Talk of ‘no deal’ is ramping up, and crucially it might not be until early next year before a deal to avert a cliff edge scenario is struck. Until then, there's a risk consumer and business sentiment starts to deteriorate.

Having said all that, the Bank has announced explicitly for the first time that it estimates the longer-term neutral rate to be 2-3%. Depending on how you look at it, this could be interpreted as a subtle prod for markets to lift their rate expectations for two-three years’ time. That’s possibly a stretch, but either way, with Brexit risks mounting, markets are unlikely to take too much notice.

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